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Chile: The Junta's Second Year

The impact on the junta's economic policies during its first year in power has been mixed. Steps to eliminate most price controls and end public ownership of many industries caused prices to rise sharply. High prices for food and petroleum imports and periodic devaluation of the escudo to end its overvaluation have added to the inflationary spiral. The government's timid stabilization efforts involving tight controls over wages and reducing the budget deficit and the growth in the money supply failed to halt the debilitating inflation. Runaway inflation thus became the junta's most pressing economic problem.

In the first eight months of 1974, the cost of living skyrocketed 204%. The rate of increase in July and August, however, was somewhat below the average for the first half of the year. If the lower rate is maintained, inflation for the year will be "held" to 350%, sharply below the 710% registered in 1973.

Other difficult domestic problems face the junta. Inflation has reduced consumer demand, which, in turn, has caused industrial output to stagnate. An expected 35% increase in agricultural production will not materialize because severe rains and floods in June disrupted plantings

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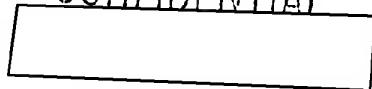
and destroyed 10% of the winter wheat crop. As a result, Chile's import needs will reach about 1 million tons of wheat in 1975 -- about as much as 1974 imports.

Although high copper prices and output and the roll-over of Santiago's massive foreign debt is giving Chile its best external payments position since 1970, the outlook for 1975 is bleak. Economic slowdowns in industrial countries have caused the international price of copper to drop more than 50% from its April peak. Even with an anticipated 6% increase in copper production next year, it is estimated that copper export earnings will be \$250 million below the 1974 level. Other exports, comprising less than 20% of Chile's total exports, are not expected to rise enough to offset the fall in copper earnings. Meanwhile, imports are expected to increase. Even assuming a healthy agricultural recovery, Chile will still need food imports estimated at about \$500 million. As a result, the trade deficit in 1975 will total \$350-\$450 million and the current account deficit about \$600 million. Santiago can expect private capital inflows of about \$50 million and credit drawings of about \$250 million to ease the remaining payments gap, the junta will have to find about \$300 million in new credits and solicit another round of debt relief.

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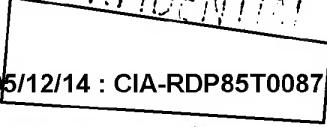


Despite the economic problems, the junta still believes that its policies will produce the desired results. The stabilization program is being tightened even at the cost of further dampening economic activity and raising unemployment. Government expenditures are to be sharply reduced by cutting government payrolls. State enterprises, particularly the Copper Corporation (CODELCO), the Pacific Steel Company (CAP), and the National Petroleum Enterprise (ENAP), are being required to become self-supporting. New investment proposals by CAP and ENAP were recently rejected as inflationary, despite the prospective long-run addition to productive capacity.

Government actions will add to unemployment, at 10% already the highest rate in 15 years. This does not include a much larger figure for underemployment. The rate is expected to rise in 1975. Moreover, real wages are expected to drop further. The resulting reduction in effective demand will be the chief constraint on the growth of industrial output.

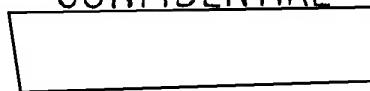
The junta is attempting to attract foreign investment as part of its program to stimulate the economy. A new foreign investment statute introduced in July seeks to assure foreign equity that it will receive equal treatment with domestic investment and be free to repatriate capital and projects. Response, however, has been limited.

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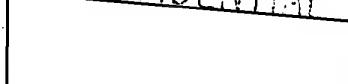
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Foreign investors are most interested in mineral exploitation. The Japanese are participating in an iron ore mine and pelletizing plant project and Canadian investors reportedly are interested in the El Abra copper deposits. However, the long lead time involved in such undertakings and their small employment requirements will limit the stimulative impact in the short run.

The outlook for the Chilean economy during the junta's second year in power is for a continuing battle against inflation. The dampening effect of government policies and lower world copper prices will constrain economic growth. Large credit inflows and another debt rollover will be required to prevent a serious balance of payments deficit. Continuing erosion of domestic purchasing power, particularly hard on the poor and middle class, may provoke unrest. The junta is determined to continue its policies even in the face of these problems. Some advisors, particularly the Committee of Advisors to the Junta (COAJ), have championed a less severe policy, but have been unable to influence junta economic policies.

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MEMORANDUM FOR: [REDACTED]

D/OER, [REDACTED]

Attached is the information you requested on 4 September 1974 on prospects for the Chilean economy during the junta's second year in power. If you have any question, please contact [REDACTED]

[REDACTED]

(S-6452) 12 September 1974
(DATE)

101 FORM NO. 101 (47)
1 AUG 54 REPLACES FORM 101 WHICH MAY BE USED.